IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

No.

In the Matter

of

GEORGE ARKY, formerly doing business as Lawrence Electric Construction Co., Bankrupt,

Petitioner,

LOUIS P. ROSENBERG, Trustee,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

The Opinion of the Court Below.

The Circuit Court of Appeals for the Second Circuit affirmed the judgment of the United States District Court for the Southern District of New York, denying a discharge to the petitioner herein without an opinion. The opinion in the United States District Court rendered by Judge Inch does not seem to be officially reported as yet.

II.

Jurisdiction.

The judgment sought to be reviewed is that of the United States Circuit Court of Appeals for the Second Circuit, dated December 3rd, 1943 affirming a judgment of the District Court for the Southern District of New York which denied a discharge in bankruptcy to the petitioner. The judgment to be reviewed involves a construction of Section 14c-3 of the Federal Bankruptcy Act.

This Court has jurisdiction to review the said judgment of the Circuit Court of Appeals for the Second Circuit under Section 240 of the Judicial Code, Title 28 U. S. C. A., Section 347 as amended under the Act of February 13th, 1925 (C. 229:43 Stat. 938), also Act of March 8th, 1934.

The revised rules of this Court adopted February 13th, 1939 and amended March 25th, 1940, October 21st, 1940 and May 26th, 1941, state among others (Rule 38-5), that a review on a writ of certiorari may be granted where a Circuit Court of Appeals has decided an important question of Federal Law which has not been, but should be settled by this Court.

Judgment sought to be reviewed herein involves a point of construction of Section 14c-3 of the Bankruptcy Act never passed upon by this Court or by any Circuit Court of Appeals other than the Court below in its holding in the case at bar.

III.

Statement of the Case.

Proceedings in bankruptcy were instituted by the bankrupt, George Arky on April 25th, 1942 by the filing of a voluntary petition resulting in his adjudication on the same day (R., p. 1). The Trustee in bankruptcy filed specifications of objections to the bankrupt's discharge on August 28th, 1942, consisting of grounds numbered 1 and 2 (R., pp. 1 and 2). The latter was subsequently withdrawn by the Trustee and evidence was offered solely as to number 1 (R., p. 33).

After hearings conducted, the Referee in Bankruptcy found that on August 9th, 1939, the Bankrupt issued a financial statement to the Public National Bank and received a loan of $504 on the strength of an endorsement and the said financial statement (R., p. 33).

The loan was paid off at the rate of $42 a month until February 1940, when it was refinanced to reduce the payments. The loan was paid off on March 7th, 1941, a year and over a month prior to the time the petition in bankruptcy was filed (R., p. 22).

The bankrupt was an electrician, employed one girl, did not employ a bookkeeper and kept his own books. His experience was limited as he was in business but a short time (R., pp. 12, 13).

The financial statement in question set forth bankrupt's accounts payable in the sum of $1100. Actually the Referee found that on the day in question the accounts payable amounted to $1642.81 (R., p. 33).

Accordingly, the Referee found that the specification of objection to the discharge was sustained. He overruled bankrupt's contention that since the loan was repaid prior to the bankruptcy the false statement would not constitute a bar to his discharge (R., pp. 34, 35).

The Referee cited in support of this holding, *In re Ernst*, 107 Fed. (2) 760, although it is difficult to see how this case could be an authority for the Referee's point since the denial of a discharge was predicated therein on the proposition that the creditor to whom the false financial statement was issued had been only partially paid off.

The Referee's decision was appealed to the United States District Court for the Southern District. In affirming the Referee, Judge Inch indicated a hope for Congressional action to change the holding he felt constrained to follow, stating,

> "It was not required that the statement be given any particular time prior to the bankruptcy, and until Congress does so this Court must follow—*Remington on Bankruptcy* (5 ED) Vol. 7, Section 3339.50; *In re Tereus*, 172 Fed. 938" (R., p. 36).

In examining the authorities cited by Judge Inch, we find that Section 3339.50 of Remington on Bankruptcy deals with the date of the financial statement without regard as to whether or not the loan secured thereby was paid. The latter situation is discussed in Section 3340 as hereinafter will appear. *In re Tereus* (*supra*) is authority for the petitioner, holding that regardless of the date of the statement, discharge will be denied provided, however, that property has been obtained on the strength thereof within four months of the bankruptcy.

The Circuit Court of Appeals for the Second Circuit affirmed Judge Inch's decision without an opinion.

IV.

Specifications of Error.

1. The Court of Appeals erred in construing Section 14c-3 of the Bankruptcy Act to mean that it provides for the denial of a discharge on matters entirely unconnected with the subject matter of the proceedings.

2. The Circuit Court of Appeals erred in construing Section 14c-3 of the Bankruptcy Act to mean that a false financial statement issued years before the Bankruptcy, may be the basis for denying a discharge even though the loan secured thereby has been paid off in full, years prior to the filing of the petition.

3. The Circuit Court of Appeals erred in denying the discharge to petitioner based on its construction of Section 14c-3 of the Bankruptcy Act, when the bank to which the false financial statement was issued ceased to be a creditor at the time of the bankruptcy.

V.

Summary of the Argument.

1. A discharge should not be denied to the bankrupt on the basis of having issued a false financial statement, when the loan obtained thereby has been fully paid off prior to the bankruptcy.

2. The doctrine that one coming into equity should do so with clean hands, does not extend to matters unconnected to the subject matter of the proceedings before the Court.

VI.

Argument.

POINT I.

A discharge should not be denied to the bankrupt on the basis of having issued a false financial statement, when the loan obtained thereby has been fully paid off prior to the bankruptcy.

Section 14c (3) of the Bankruptcy Act provides the following:

> "A bankrupt may be denied a discharge if he has
>
> (3) obtained money or property on credit or obtained an extension or renewal of credit by making or publishing or causing to be made or published in any manner whatsoever a materially false statement in writing respecting his financial condition."

Remington on Bankruptcy (5th Edition), 7th Vol., Section 3340, in discussing the effect of paying the defrauded creditor prior to the bankruptcy, sets forth the doctrine that such payment would nullify the reason for denying a discharge.

In support of this view, Professor Remington cites the case of *In re Milhoff*, 40 A. B. R. 72 (Special Master Ohio, affirmed by District Court), a "well considered case", where the Referee reviewed all the authorities on the point and came to the conclusion that the gist of the wrong done because of which the bankrupt is to lose his right to his discharge, is fraud and deceit. Accordingly, if at the time of bankruptcy there is no creditor who has

been defrauded, there can be no objection to the discharge under the Section.

> "* * * the gist of the wrong perpetrated by the bankrupt because of which under this section bankrupt is to be denied his discharge, is fraud, deceit. It is because he has knowingly defrauded a person by securing credit. If at the time of bankruptcy there is no person who has been defrauded how can it be said that there is room for objection under this section?"

> "It would seem to me to be a more reasonable inference, from the language of the Act, that Congress meant a creditor at the time of bankruptcy than that it meant a past creditor, who, ten or twenty years or longer before bankruptcy had extended credit on a false statement and been paid in accordance with the terms of credit extended * * * I quite agree with him, that if, at the time of bankruptcy there exists no creditor unpaid because of credit extended upon a false statement, it would be harsh, indeed, if not shocking, to common sense to hold that the mere fact of extending credit without actual defrauding of the creditor, could be relied on as a basis of discharge opposition, regardless of what period in the life of the bankrupt this had occurred."

The same view was expressed by Brandenburg on Bankruptcy (30 Edition, Section 370),

> "While no specific time is fixed by the Statute within which such statement must have been made, by analogy to other provisions of the law, it is evident that Congress intended that the statement must have been made within four months of the institution of the bankrupt's proceedings."

In the case of *In re Ernst*, 107 Fed. (2) 760 (Circuit Court of Appeals, Second Circuit 1939), the decision granting the bankrupt's discharge in the District Court was reversed on the reasoning that the false financial statement issued by the bankrupt was instrumental in obtaining two loans from one of his creditors and *one of such loans has not yet been paid off*.

The bankrupt's discharge was denied in the case of *Josephs* v. *Powell & Campbell* (*supra*) where the Court below overruled the District Court. The District Court gave permission to the bankrupt to pay the creditors that relied on the false financial statement *nunc pro tunc*. This was reversed, the Circuit Court of Appeals specifically basing the denial of the discharge on the fact that the creditors involved were not paid prior to the filing of the bankruptcy petition.

The case of *In re Terens*, 172 Fed. 938, cited by Judge Inch in the United States District Court, in the holding below denying discharge, is in effect authority in favor of petitioner, ruling that the date of the false financial statement is immaterial provided, however, property on the strength of it is obtained during the four month period preceding the bankruptcy. (The fact is, of course, in the case at bar, that the loan was obtained two years prior to the bankruptcy and paid off over a year prior thereto (R., p. 22).)

POINT II.

The doctrine that one coming into equity should do so with clean hands, does not extend to matters unconnected to the subject matter of the proceedings before the Court.

It may be urged against the petitioner that a bankruptcy proceeding is essentially a proceeding in equity, and that he who comes into equity for some relief must do so with clean hands; that petitioner having once in his lifetime soiled his hands by the uttering of a false financial statement, should now be forever barred from seeking equitable relief.

In a world of abstract perfection, such a doctrine may be conceivably recognized, but our Courts of equity have constantly refrained from probing the conscience and the cleanliness of hands of a litigant in regard to matters not connected with the case at bar. Indeed it is elementary that even equitable considerations must be relevant to the issues involved.

In a proceeding wherein a bankrupt seeks his discharge from his creditors, it appears absurd to contend that such discharge should be withheld based on a far-gone transaction in some by-gone year, wherein a false financial statement was given to one, an entire stranger to the bankruptcy proceedings, no longer a creditor and one whom the bankrupt has paid off in full 2, 5 or 10 years prior to the bankruptcy.

> "I do not believe that Congress intended to bar the door to a sinner who has repented. I do not believe that the sins of a lifetime which are wholly unrelated to a matter before a Court should be regarded by a

Court unless it appear that the sinner is unrepentant and still engaged in his evil course." *In re Weinstein*, 34 Fed. (2) 964 (District Court of California).

See also,

In re Terens (*supra*).

"The section of the Act here involved does not require that the property be unpaid for it merely requires that it be obtained on credit on a false statement, from a person making the latter a creditor. The natural inference from this language is, however, that the person remain a creditor. In other words, that to be a valid objection there must in bankruptcy be a person, who became a creditor under the circumstances described in this section, viz; by extending credit on a false statement made to him. To say that it refers to any person who at any time in the life of the bankrupt became his creditor under these circumstances, even though he was paid promptly in accordance with the terms of credit, would be rather absurd."

In re Milhoff (*supra*).

VII.

Conclusion.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers in order that the questions herein involved and the conflict regarding thereto presently existing in the various Federal Courts, as hereinbefore pointed out, may be permanently settled by this Honorable Court, and the proper construction and interpretation made and

injustice prevented, and that to such end a writ of certiorari should be granted and this Court should review the decision of the said United States Circuit Court of Appeals for the Second Circuit, and finally reverse it.

Respectfully submitted,

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